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Perceptions and Experiences of Foreign Investors and Policy Makers

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Major Determinants and Hindrances of FDI inflow in Bangladesh: Perceptions and Experiences of Foreign Investors and Policy Makers

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Major Determinants and Hindrances of FDI inflow in Bangladesh: Perceptions and Experiences of Foreign Investors and Policy Makers

Shamima Nasrin, Angathevar Baskaran and Mammo Muchie

Abstract

Foreign Direct Investment (FDI) is perceived as an important tool to achieve industrial development and growth if Bangladesh wants to improve socio-economic indicators. This study analyzes the major determinants and hindrances of FDI inflow in Bangladesh. FDI related policies are discussed to identify the objectives of these policies. Qualitative research method is used in this study. Primary and secondary data are employed to address the research objectives. There are two target groups: foreign investors in Export Processing Zones (EPZs) in Dhaka and Chittagong and Public policy makers. The data reveals that after adopting the liberalized policy measures in 1990s there has been a significant increase in the FDI inflow. Both foreign investors and policy makers identified low cost labour as the major determinant of FDI inflow in Bangladesh and shown their satisfaction regarding the outcomes of FDI related policies. In terms of barrier to FDI inflow the most significant barrier identified is infrastructural constraint. The study further revealed that in spite of having investment-friendly policies there are some implementation problems at the levels of facilitating agencies. As Bangladesh is facing infrastructural constraints, special incentives packages can be offered as policy incentive to the investors for certain period who will invest in this sector. Beside this necessary logistic support, more simplified bureaucratic procedure, prioritized investment according to the need of the regional area/ sector can contribute to increased FDI inflow to Bangladesh. Further research need to focus on the combination of market seeking and export oriented FDI in Bangladesh.

Keywords: Foreign direct investment, FDI, FDI determinants, FDI constraints, Foreign investors, Bangladesh.

1. Introduction

Foreign Direct Investment (FDI) is considered as a crucial ingredient for economic development of a developing country. Countries that are lagging behind to attract FDI are now formulating and implementing new policies for attracting more investment. Industrial development is one of the pre-requisites for economic growth particularly in a developing country. Moving from the agrarian economy to industrial economy is imperative for economic development. Bangladesh is an example in this regard. In the age of globalization the need for exchanging ideas, views, capital, human resources are becoming a burning issue. Governments also try to create a conducive investment environment by introducing economic policies, incentives for investors, privatization and so on. Therefore, it is generally believed that the contribution of FDI cannot be ignored to enhance the economic growth of a country.

Among the emerging economies India and China are the desired choice for investment (Baskaran and Muchie, 2008). The determinants which play as a driving force for attracting FDI are geographical location, cheap labour cost, and government attitude towards liberalization of the existing laws of the host country, skilled manpower, incentives for investors, and exemption of taxes etc. According to Bangladesh Board of Investment Handbook (2007) Bangladesh offers an attractive investment climate compared to other South Asian Economies.

The foremost research objective of this study is to find out the major determinants which are generally found in the literature to attract FDI and compare them with the Bangladesh context.

Government of Bangladesh reformed the economic policy to attract FDI. In spite of this there is a perception that the country has not made considerable success in attracting FDI. From this point of view this study has made an attempt to find out the determinants which influence FDI inflow and find out the constraints that restricted the FDI inflow in Bangladesh. It is widely accepted that favourable public policy is pivotal for attracting foreign investors. From this perspective this study will evaluate Bangladesh's FDI policy regime, particularly through the analysis of the perceptions and experiences of policy makers and foreign investors. Finally, on the basis of our findings we make some policy recommendations.

Phenomenological approach and qualitative research methods were employed for this study. To gather data about the perceptions and experiences of the two sets of target groups - policy makers and foreign investors, both questionnaire survey and interview methods were employed. That is, primary data were collected by administering a structured questionnaire from the foreign investors in Export Processing Zones (EPZs) in Dhaka and Chittagong areas of Bangladesh, and face-to-face interviews were conducted in case of policy makers to gather more in-depth information. In addition, some secondary and descriptive statistical data also were used to investigate the trend of FDI inflow in Bangladesh.

This is a short and small study and therefore it was difficult to select a large sample size for administering the questionnaire. Therefore, the small size of sample is one of the limitations of this study. On the other hand, random selection method may be biased to select the target group for collecting primary data. Primary data from the entrepreneurs of EPZs may not reflect and capture accurately the entire scenario of FDI inflow in Bangladesh. These are other limitations of this study.

The structure of the paper is as follows: Section 2 reviews the relevant literature; Section 3 provides an analytical framework; Section 4 presents an overview of the FDI inflow in Bangladesh; Section 5 analyses the data employing the analytical framework; and Section 6 presents our conclusion and recommendations.

2. Literature Review

FDI is considered as an important tool for economic development in a developing country. If the investing country is wealthier than the host country then capital will flow to the host country (Zhao, 2003). It contributes to growth of GDP; create employment generation, technology transfer, human resource development, etc. It is also perceived that FDI can play a significant role to reduce poverty of a developing country.

Foreign Direct Investment can be defined as investment in which a firm acquires a substantial controlling interest in a foreign firm or set up a subsidiary in a foreign country (Chen, 2000). IMF (1993, 2003) and OECD (1996) defined FDI as a long term investment by a foreign investor in an enterprise resident in an economy other than foreign direct investor is based. According to the Balance of Payment Manual (1977 and 1993) FDI refers to investment made to acquire lasting interest in enterprises operating outside of the economy of the investor.

In the developing world, the East Asian countries - South Korea, Hong Kong, Taiwan and Singapore were the first to use effectively the FDI from TNCs to achieve economic development

(Sinha, 2007). After opening up their economy towards FDI, these countries emerged as 'Asian Tigers' and witnessed rapid economic development within a relatively short period of time. In recent years, many countries have introduced open door policy to attract FDI with a view to increase investment, employment productivity and economic development (Agiomirgianakis *et al.*, 2003). A number of empirical studies have shown that developed and developing countries both desire to attract FDI. Developing countries always are in disadvantage in terms of technology, capital, and human resources at the early stage of development. In FDI literature it is already recognised that FDI not only brings capital for productive development to the host economy, it also transfers a considerable amount of technical and managerial knowledge and skills, which is likely to spill over to domestic enterprise in that economy (Balasubramanyam *et al* 1996; Kumar and Podhan, 2002). It is recognised that FDI can contribute to the growth of GDP, Gross Fixed Capital Formation (GFCF) (total investment in a host economy) and balance of payments (Baskaran and Muchie, 2008).

Most Developing countries are always at a disadvantaged position in terms of technology and in this regard FDI contribute to transfer technology and can contribute towards income, production, prices, employment, economic growth, development and general welfare of the host country (Kok and Ersoy, 2009). Agiomirgianakis *et al* (2003) suggested that as FDI increases the total output of the host country, it eventually contributes to the economic development of the host country. To achieve industrial expansion a country should produce high quality products and accomplish market efficiency. To facilitate this technological development is imperative. A developing country like Bangladesh that is at an early stage of development has to rely on FDI as an important vehicle to bring in technological development. Hence, it is perceived that FDI is capable of increasing the technical capabilities of the host country.

According to Sun (1998) FDI has extensively helped economic growth in China by enriching domestic capital formation, increasing exports, and creating new employment. Khoda (2003) stated that FDI can raise domestic capital, engender employment by using underutilized labour, build up organizational formation as well as managerial standards of the host country, transfer technology, get better internal and overseas marketing network and also assist to improve the technical expertise of the Government. It is argued that "MNEs are subject to use up more on R&D abroad than at home and their foreign affiliates act comparatively better in terms of productivity" (Chen, 2000, p. 37). Mmieh and Frimpong (2004) study on the FDI experience in Ghana reveals that the economic reform has contributed to attracting significant multinational investment. They also stated that changes to policies and regulations have helped to increase FDI inflow in China, India, Korea and Mexico.

The year 1990 was considered as the year of liberalization of laws, rules, regulations which influenced the foreign direct investment of developing countries. *World Development Report* (1991) concluded that development perspective had changed significantly. Bangladesh opened up its economy in 1990 and started drawing the attention of foreign investors. Mortoza and Das (2007) empirically shown that liberalization of trade had an impact on FDI in Bangladesh. As per Investment Handbook (2007) of Bangladesh Board of Investment (BOI) it is now simpler to do business in Bangladesh than many developing economies. Report of 'Doing Business' jointly published by the World Bank and IFC ranked Bangladesh in the 68th position in terms of starting business among 175 economies. World Bank (2005) advocated that Bangladesh can attain physical capital, technology transfer, sharpen the competitiveness among domestic investors

through the proper utilization and allocation of resources. In 1990 the economy of Bangladesh has made remarkable advancement in terms of Gross Domestic Product (GDP) growth, which was around 5%. The 4th survey of FDI inflow by BOI in Bangladesh stated that the cost of investment in Bangladesh has become cheaper compared to the previous years. But Mondal (2003) found that FDI inflow to Bangladesh is constrained by six factors: (i) Political instability; (ii) Sluggish steps towards privatization; (iii) High business cost; (iv) Tax hazards; (v) Threats related to finance; and (vi) Incompetent or futile capital market.

Other studies also identified infrastructural, bureaucratic, environmental factors and political instability as constraints that restrict the inflow of FDI (Mian and Alam, 2006; Kafi *et al.*, 2007). According to Musila and Sigue (2006) it is important to maintain political, sound macroeconomic stability and a favorable policy regime to successfully attract a large volume of FDI. Alam *et al* (2006) have empirically shown that the macroeconomic environment in Bangladesh is congenial for attracting foreign investment. Since the inception of BEPZA it has been playing a very important role for economic development of Bangladesh through export promotion, employment creation, technology transfer, and development of forward and backward linkages of industries and so on.

SWOT analysis of Bangladesh economy by Salman (2009) suggested that the Bangladesh has huge investment opportunities, but it has to develop and exploit it properly. The study highlighted that as Bangladesh has access to major export markets such as the EU, Canada, Japan, New Zealand, and Australia, it is essential to diversify products if the country intend to avail the benefits from trade concessions. But, according to WEF's Global Competitiveness Report (2008-2009) Bangladesh ranks 111 out of 134 countries in terms of business environment and "the business climate in Bangladesh is poor and less competitive in global context and the environment is deteriorated in 2007" (2008-09, p.49). It also pointed out that the ranking deteriorated compared to the previous year when it ranked 107 out of 131 countries.

To sum up, the literature review suggests that FDI is an important tool for the economic growth in a developing country such as Bangladesh. Literature review also revealed that there are contradicting perceptions, facts, and findings about the investment environment and doing business in Bangladesh. In the next section we will propose an analytical framework to evaluate the FDI flow in Bangladesh and to analyze the perceptions and experiences of two target groups: the policy makers and the foreign investors.

3. FDI Flow – An Analytical Framework

We propose an Analytical framework to analyze the FDI in Bangladesh which identifies four major factors: *Economic Environment*, *Political Climate*, *Institutional Factors and Government Initiatives*, and *Infrastructural Facilities*, as determinants/ hindrances to the FDI flow. We develop and present our analytical framework by reviewing the existing FDI literature.

(i) Economic Environment

A large volume of literature identified economic environment of the host country as one of the important factors for FDI (e.g. Dunning, 2001). OECD (2000) categorizes FDI as: (i) market seeking; and (ii) export oriented. It also suggested that while size and growth of the economy

attract market seeking FDI, export oriented FDI mainly is inclined towards cost effectiveness. Zheng (2009) also argued that market seeking FDI is always attracted by the market size and market growth. The size of the market and level of economic development play an essential role in attracting foreign investors (Agiomirgiankis *et al.*, 2003; Seyoum, 2009; Nunnenkamp, 2002). Fung and Zhang (2002) illustrated that export oriented FDI is mainly attracted by low cost of labour, transport communications, tax holiday and cheap cost of land fees. In case of export oriented FDI firms, they tend to shift the production area in order to acquire inexpensive inputs such as raw material and low cost labour, that is, to minimize production cost (Henly, 2004). Quazi (2007) which found that countries can attract more FDI by improving their domestic investment climate through, among other policies, tax and tariff reform, reducing government ownership of business, and liberalizing the banking and financial sectors.

(ii) Political Climate

Schneider and Bruno Frey (1985) and Mmieh and Frimpong (2004) found a negative relationship between FDI inflow and political unrest such as strikes and riots in the host countries. According to UNCTAD (1991, p.2): “political stability is one of the key factors in the policy framework of the Government to facilitate FDI in host countries”. An uncertain political environment deteriorates the trust as it makes the investor feel insecure (Hakro and Ghumro, 2007). Azim and Uddin (2001) revealed that absence of transparency in the Government sector, corruption, fanatic nationalism, perpetual change of the Government, likelihood of terrorism are taken into account by the investors before making investment decision in a foreign country.

(iii) Institutional Factors and Government Initiatives

The neoclassical literature assumes that if a government work hard to build up good investment climate in a country, then investors will automatically select it because of best investment opportunities (Morisset and Andrews-Johnson, 2003). Young *et al* (1994) stated that a number of factors such as policy formulation, investment promotion and attraction, investment approvals, granting of incentives, providing assistance, and monitoring clients play a major role in establishing a successful FDI policy regime. A stable macroeconomic policy and liberalization of FDI policies played a vital role in stimulating FDI in Latin America (e.g. Brazil) (Nunnenkamp, 1997). The importance of the role of host country Government to enhance the quality and quantity of FDI has been emphasized in several studies (e.g. Stover, 2005). Dunning (1981, 1988) has explained the term locational advantage and identified investment incentives, government support, language, culture, methods of doing business and ideology as factors influencing FDI flow.

The legal policy regime of the host country also constitutes a potential FDI determinant (Luiz and Mello, 1997). Globerman and Shapiro (2002, 2003) have shown that unequivocal, neutral legal framework and better protection of property rights can lead to increased FDI. A large number of studies demonstrated that the quality of institutions is an important variable to foster the FDI inflow (e.g. Benassy-Quere *et al.*, 2007; Everhart *et al.*, 2003; Habib and Zurawicki, 2002; Kinoshita and Campos, 2003; Knack, 2001; Wesberry, 1998). For instance, the amount of bureaucracy and corruption in the country, as well as the quality of information, banking and legal institutions can be main determinants of inward FDI. Seyoum (2009) studied 84 countries and statistically found that qualities of formal institutions are positively co-related with the FDI

inflow. He also argued that formal institutions should have free and fair judiciary, competent and effectual legal framework clearly expressed and well protected property rights and unbiased Government bureaucracy.

(iv) Infrastructural Facilities

Infrastructure facilities include transportation system, port facilities, utilities, energy, etc. A host country's infrastructure facilitates the investment climate of a country. A good and productive infrastructure influenced the investors to make investment (Rolfe and White, 1992; Guisinger, 1985; Asiedu, 2002; Biswas, 2002). For example, better roads and communication system influenced investors to invest in a country since physical infrastructure positively influences productive efficiency (Lall *et al.*, 2000).

To recapitulate, we have developed an analytical framework: *Economic Environment, Political Climate, Institutional Factors and Government Initiatives*, and *Infrastructural Facilities*; by identifying the crucial determinants/ hindrances of FDI in developing countries based on the previous literature. We will employ this to evaluate the FDI flow in Bangladesh.

4. Overview of FDI Inflow in Bangladesh between 1998 and 2007

This section discusses the FDI inflow to Bangladesh during 1997-2008 and also analyses the sectoral distribution of FDI in its economy.

Bangladesh has liberalized the economy in early 1990s and introduced investment incentives to create a favourable climate for FDI. Before this the FDI inflow was not significant due to the absence of the favourable policy framework. According to Bangladesh Board of Investment (2007) FDI has contributed to revamping the economy of Bangladesh since liberalization. Except nuclear energy, defence equipment, reserved forest area, security printing and mining, and railway, all other sectors are open for FDI. Domestic savings of Bangladesh is very low which implies low level of investment. In this context FDI is perceived as an important tool for the industrial development. In 1983 Bangladesh has established first Export Processing Zone (EPZ) in Chittagong to provide friendly business environment. Presently the country has 8 EPZs all over the country. According to Bangladesh Investment Handbook (2007) and UNCTAD (2008) annual FDI inflow in 1972 was just \$0.090 million and it reached \$666 million in 2007 (it was \$793 million in 2006). FDI flow increased after 'Foreign Investment Promotion and Protection Act -1980 was introduced by the Government which aimed to make favourable environment for investment. However, it remained sluggish in the 1980s. In 1990 the FDI inflow reached US\$ 3.2 million (UNCTAD, FDI database, 2004).

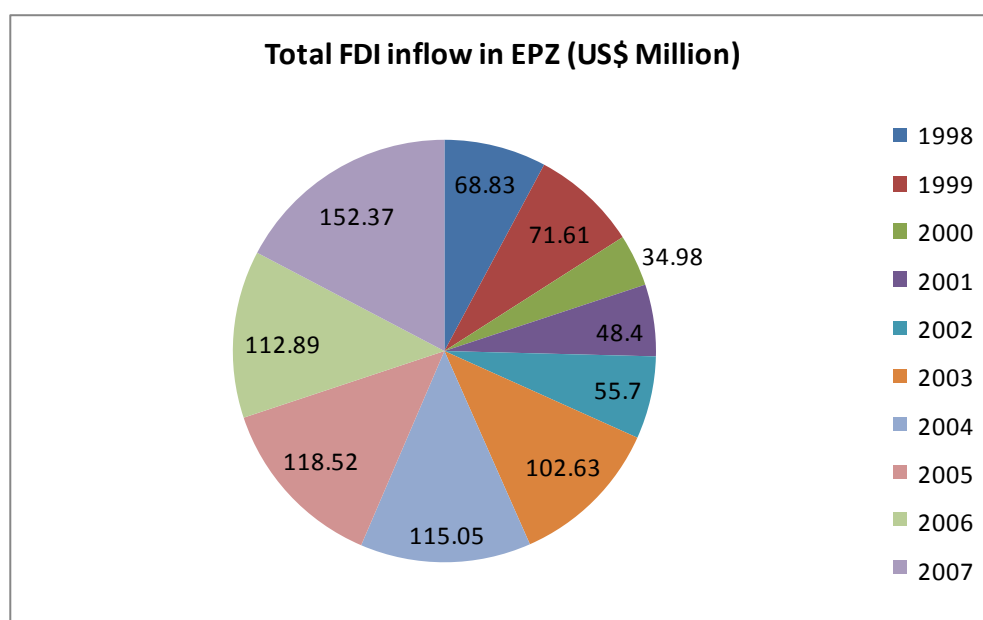
Table 1: Total FDI inflows to Bangladesh between 1998 and 2007 (US\$ in millions)

FY1998	FY1999	FY2000	FY2001	FY2002	FY2003	FY2004	FY05	FY06	FY2007
576.5	309.1	578.6	354.5	328.3	350.2	460.4	854.3	772.9	666

Source: Bangladesh Bank (various years), *Annual Reports*, Dhaka: Government of Bangladesh.

Table 1 shows the total FDI in Bangladesh between 1998 and 2007 (BOI and BEPZA). The table shows that the FDI flow was inconsistent until 2004, but significant overall. In 2005 the FDI has doubled relative to 2004 and this amount was the highest volume since the independence. Bangladesh Investment Handbook (2007) stated that this was the second highest volume among other South Asian countries. But in 2007 it again dropped due to political unrest, bureaucratic hassles and infrastructural difficulties (World Investment Report, 2008). From Table 1, we can observe that there was a considerable drop in FDI inflow in FY2001 compared to 2000. Political instability has been identified as the root cause for this downswing (Robin, 2006). World Investment Report (2008) also reported that the FDI inflow in Bangladesh has slumped by 16 per cent in 2007 in contrast to the inflow in 2006, although in Asia the inflow has been boosted by 18 per cent. It is clear that the FDI inflow has risen in 1990s after changes were introduced to the rules and regulations regarding investment. Bangladesh Bank (2008) revealed that the aggregate FDI inflow in Bangladesh was US\$ 5,510 million during 1998-2007. Sahoo (2006) noted that active role of BOI contributed towards establishing congenial FDI climate in Bangladesh. It is also notable that this is the accumulated figure of investment made in EPZs and through registration in BOI. Figure 1 illustrates the total FDI flow to EPZs between 1998 and 2007.

Figure 1: Total FDI inflow to Export Processing Zones (EPZs) in Bangladesh



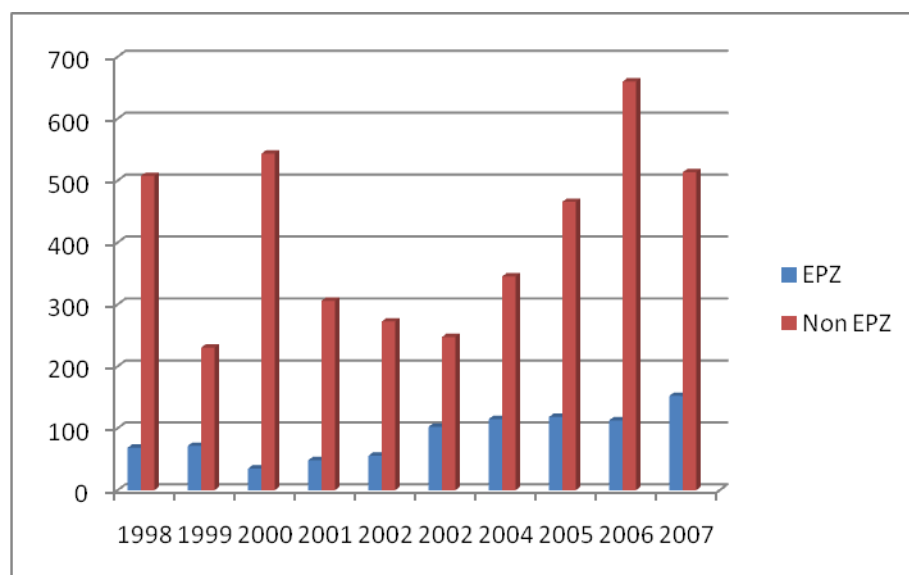
Source: Bangladesh Export Processing Zone Authority, Dhaka: Government of Bangladesh, Available at <http://www.epzbangladesh.org.bd/>

While Figure 1 shows that the highest amount of investment in EPZs occurred in 2007, the total FDI in the country reached the peak in 2005 (see Table 1). This implies that FDI decreased in 2005 in other areas rather than in EPZs. A closer look at the total FDI inflow trend in the country suggests that the inflow was high outside EPZ area. Figure 1 also illustrates that after 2000, the FDI inflow to EPZs increased steadily.

It is also noticeable that FDI inflow to EPZ went down sharply in 2000. Political instability was one of the main reasons for this fluctuation and it took over three years for FDI flow to cross the level of 1999. From Figure 1 it can be said that FDI inflow became significant only from 2003.

In Bangladesh foreign firms can be registered either through BOI or BEPZA. EPZ industries are mainly export oriented which includes both foreign and local firms. Other firms/industries outside the EPZ are operating business directly aimed at the Bangladesh domestic market. Figure 2 shows the volume of FDI flow separately in these two areas during 1998-2007.

Figure 2: Comparison of total FDI inflow from 1998- 2007 in EPZs and Non-EPZ area¹

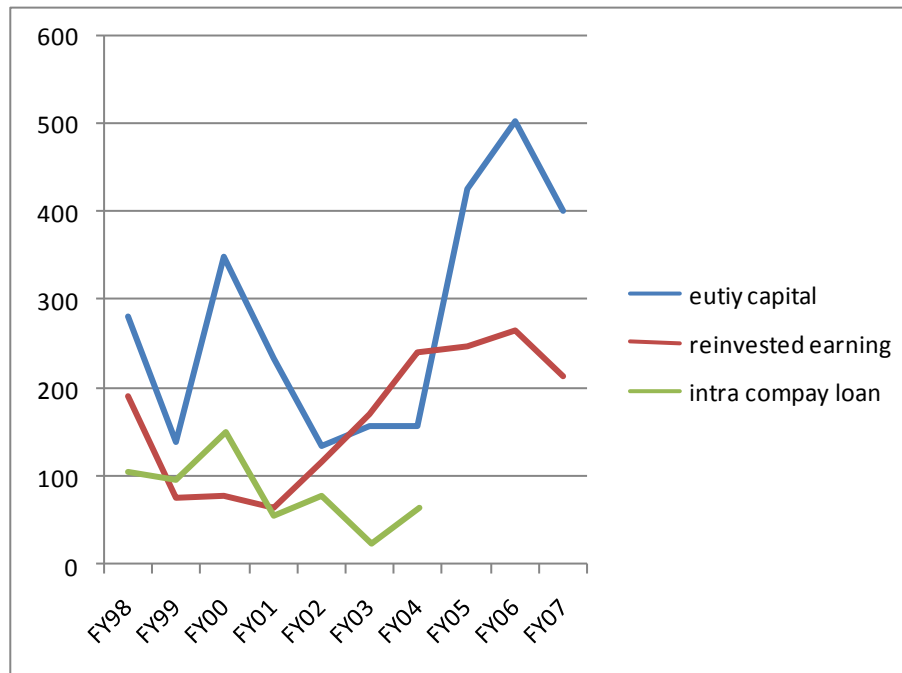


Source: Bangladesh Export Processing Zone Authority, Dhaka: Government of Bangladesh. Available at: <http://www.epzbangladesh.org.bd/>

Figure 2 clearly shows that FDI inflow is always higher in Non-EPZ area than EPZ area. While FDI flow to Non-EPZ area reached the highest point in 2006, it was at the highest point in 2007 in EPZ area. We can see clearly that there was a sudden jump of Non-EPZ FDI from 1999 to 2000. In Bangladesh only 8 EPZ are presently operating in the country where 264 firms are located. The above comparison shows that bulk of the volume of FDI inflow has come through Non-EPZ area.

UNCTAD uses three categories of FDI inflow: (i) equity capital; (ii) reinvested earning; and (iii) intra company loans. Equity capital refers that an investor can buy share of an enterprise in a foreign country, i.e. other than the home country. Reinvested earning implies that investor's share of earning from the direct equity participation. Intra Company loan means short and long term lending and borrowing between foreign investor and affiliated company.

Figure 3: Categories of FDI Inflow to Bangladesh (1998 – 2007)



Source: Bangladesh Bank, (various years), *Enterprise Survey*, Dhaka: Government of Bangladesh.

Figure 3 reveals that the FDI flow to Bangladesh predominantly is formed of equity capital. However, it was fluctuating until 2003 and it increased sharply from 2004. While reinvesting earnings volume also forms significant part and it has been increasing until 2006, the intra company loan inflow forms a small part and has declined over the years. In Bangladesh about 90 per cent FDI inflow is in the form of equity capital.

Manufacturing and Service sector are playing the pivotal role for recent FDI inflow. The global FDI inflow has been changed and now-a-days it is moving towards the service sector where as in early 1990s the inflow in this sector was negligible. Bangladesh is also an example in this regard. FDI inflow in Bangladesh has also transformed in terms of sectoral distribution. It has changed from import substitution to export orientation in manufacturing sector. According to Monetary policy Review of Bangladesh Bank (2005) after entering into the WTO (World Trade Organization) Bangladesh has opened the service sector and made a competitive policy framework which contributed FDI inflow in Service sector. Service sector includes telecommunication, banking, power and energy.

Table 2: Sectoral Distribution of FDI in Bangladesh (US\$ in millions)

<i>Sector</i>	<i>FY 1998</i>	<i>FY99</i>	<i>FY00</i>	<i>FY01</i>	<i>FY02</i>	<i>FY03</i>	<i>FY04</i>	<i>FY05</i>	<i>FY06</i>	<i>FY 2007</i>
Agriculture	1.4	2.9	15.2	1.1	1.6	4.1	1.7	2.3	1.8	2.4
Manufacturing	139.8	191.8	193.5	132.2	142.9	165.2	139.4	219.3	240	289
Petroleum & Gas	235.2	83.5	301.0	192.4	57.9	88.1	124.1	168.74	181.86	204.99
Telecom	25.3	0.5	5.4	0.9	48.5	45.9	127.5	261.89	278.84	346.50

Source: Bangladesh Bank (2006), *Policy Analysis Unit Report*, Dhaka: Government of Bangladesh; Bangladesh Bank (2008), *FDI Survey Report (July-December)*, Dhaka: Government of Bangladesh.

In Table 2 only the prominent sectors that received FDI in are exhibited. Table 2 indicates that presently telecommunication sector is receiving a large volume of FDI inflow compared to other sectors due to the growth of private telecom sector. It is also notable that in 1999 manufacturing sector contribution was about five fold than telecommunication sector, as private telecommunication sector was nearly non-existent until 2000. Agriculture sector is showing a steady growth over the years. In 2000 FDI in this sector was significant and after that it showed a stable growth. But in case of Petroleum & Gas sector the growth trend is fluctuating over the years. FDI inflow in telecommunication sector has started to rise from 2002 and increased about seven fold by 2007. This suggests that in Bangladesh economy service sector is dominant in attracting FDI inflow.

Bangladesh receives FDI from both developed and developing countries. The major investors come from 36 different countries. According to Bangladesh Bank Statistics department (2006) among the 36 countries 21 countries are from developing and transition economies. Bangladesh Bank also revealed that Bangladesh received about 70 per cent of total FDI inflow from only 11 countries. Table 3 provides data for the top 9 country-wise sources of FDI to Bangladesh.

From table 3 it is clear the USA and the UK are the major investors. Among the developing countries, UAE increased the investment significantly in 2006 after entering in the Bangladesh market with cell phone business Warid Telecom and another Egyptian cellular company Banglalink came in 2004 with 19.90 (US\$ in millions) and hence Egypt has been increasing its FDI in Bangladesh. Malaysia is also investing significantly in Telecom sector through Aktel and has been increasing its volume of FDI over the years. However, FDI from Malaysia dropped sharply in 2007. Singapore is also mainly investing in the telecom sector and increased the volume significantly in 2005. Although its investment declined since 2006, it still remains significant. A fluctuating trend is observable in case of Norway as their investments are also mostly in Cell phone business. Apart from these five countries FDI from other countries are combinations of export oriented and resource seeking investments. While FDI from South Korea has decreased gradually, investments from Hong Kong-China have increased steadily.

Table 3: Sources of FDI for Bangladesh – Country-wise FDI Inflow between 1998 and 2007 (in US\$ in millions)

<i>Country</i>	<i>FY 1998</i>	<i>FY99</i>	<i>FY00</i>	<i>FY01</i>	<i>FY02</i>	<i>FY03</i>	<i>FY04</i>	<i>FY05</i>	<i>FY06</i>	<i>FY 2007</i>
USA	232.90	66.94	29.30	29.10	24.50	32.10	61.80	105.90	187.60	161.51
UK	40.93	35.61	157.00	52.90	18.50	83.60	91.00	153.50	77.88	123.74
UAE	0.18	1.58	0.00	0.90	0.00	16.70	12.80	12.81	100.5	62.02
Singapore	0.50	1.10	1.90	1.60	12.70	3.20	2.30	97.55	26.32	11.78
South Korea	70.94	101.36	31.40	16.80	30.70	24.50	18.50	26.26	50.14	30.06
Hong Kong - China	13.14	20.52	14.80	5.80	17.10	11.70	13.90	39.32	43.33	62.49
Egypt	0.00	0.00	0.00	0.00	0.00	0.00	19.90	48.40	67.39	123.46
Norway	23.71	3.31	0.00	0.00	26.40	21.90	59.60	53.50	82.96	25.67
Malaysia	5.01	2.91	6.20	0.30	11.40	13.40	39.00	33.10	44.47	19.55

Source: Bangladesh Bank (various years), *Annual Reports*, Dhaka: Government of Bangladesh, Bangladesh Bank (2008), *FDI Survey Reports*, Dhaka: Government of Bangladesh.

5. Major Determinants and Hindrances of FDI in Bangladesh: Survey Data and Discussion

The main objective of this study was to find out the major determinants and hindrances of FDI inflow in Bangladesh. For this, a survey of foreign investors and policy makers was conducted. The survey specifically concentrated on the foreign investors of Export Processing Zones (EPZs) and high level officials of BOI, BEPZA, Ministry of Commerce, Ministry of Industries, and Export Promotion Bureau. In all, the survey involved 27 respondents, that is, 10 high level officials in the Government and 17 foreign investors in EPZs. Among the 17 foreign investors, 7 were from Dhaka Export Processing Zone and 11 were from Chittagong Export Processing Zone. Structured questionnaires were sent to the foreign investors and face-to-face interview was done in the case of policy makers.

The data gathered were categorised under specific themes: (i). Motivational factors/ Major determinants; (ii) Major barriers to FDI flow; (iii) FDI policy regime; (iv) Evaluation of progress in attracting FDI flow to Bangladesh; (v) Prospective sectors for future investment; (vi)

Economic environment; (vii) Political climate; and (viii) Institutional factors and government initiatives. The summary of data and findings are provided in Table 4.

Table 4: Determinants and Hindrances of FDI in Bangladesh - Summary of Data and Findings

<i>Data Theme/ Category</i>	<i>Response from Foreign Investors</i> <i>(Total Respondents =17)</i>	<i>Response from Government Policy Makers</i> <i>(Total Respondents =10)</i>
(i) Motivational Factors/Major Determinants		
(a) Availability of Low Cost labour	71% - YES	70% - YES
(b) Incentives/ Investor Friendly Policy Regime	47% - YES	80% - YES
(ii) Major Barriers to FDI Flow		
(a) Infrastructure Constraints	59% - YES	90% - YES
(b) Complex Bureaucratic Procedures	12% - YES	24% - YES
(c) Difficulties in FDI Policy Implementation	Only Few Responses	70% (Significant)- YES
(iii) FDI Policy Regime		
(a) Satisfaction with the Framework of Existing Policy Regime	72% - YES (6 respondents failed to answer to this question)	80% - YES
(b) Satisfaction with the Performance of FDI Policy Regime	65%	60% – SATISFIED 40% – NOT SATISFIED
(iv) Evaluation of Progress in Attracting FDI Flow to Bangladesh		
(a) Progress in Attracting FDI Flow	57% - GOOD/ SATISFACTORY 43% - NOT SATISFACTORY (4 respondents failed to answer to this question)	90% - GOOD/ SATISFACTORY
(v) Prospective Sectors for Future Investment		
(a) Identify Prospective Sectors for Future Investment	Respondents identified the same sectors where they have invested already and are currently operating	Respondents identified completely new sectors where there is no FDI flow currently

(vi) Economic Environment		
(a) Macroeconomic Indicators as Drivers of FDI	100% - NO (This may be because the sample is only from EPZs)	Only one response i.e. persistent GDP growth rate
(b) GSP Facilities with the EU was Motivation for Investing in Bangladesh	18% - YES	Only one response
(vii) Political climate		
(a) Political Unrest/ Instability is a barrier to FDI Flow in Bangladesh	Only 1 out 17 respondent said – YES This may be again because the sample is only from EPZs or the foreign investors have taken a long-term view.	100% - NO
(viii) Institutional Factors and Government Initiatives		
(a) Satisfaction with Institutional Factors and Existing Government Initiatives to attract FDI in Bangladesh	47% - YES	80% - YES

(i) Motivational Factors/Major Determinants

Both the target groups were asked to identify the major motivational factors to invest in Bangladesh. Cheap labour cost is identified as the most significant determinant and motivational factor in case of FDI inflow to Bangladesh by both target respondent groups. Among the foreign investors 71% mentioned that low cost of labour as the major motivational factor and 70% of policy makers have also recognised low cost of labour as a major factor for attracting investment to Bangladesh. The other responses mostly identified government incentives and investment friendly public policy as motivational factors. About 47% investors mentioned that present government rules, regulations, and incentives are motivational factors for their investment. About 80% policy makers stated that present government policies are investment friendly. Previous literature also indicated that the export oriented FDI inflow is mainly motivated by the availability of low cost labour in the host economy. As our study is mainly based on the export oriented foreign investors, our finding above is consistent with the literature.

(ii) Major Barriers to FDI Flow

Previous literature found that good and productive physical infrastructure is a key factor which influences FDI inflow. Good infrastructure is essential for both industrialization and attracting investment. It includes utilities (gas, water, and electricity), transport, and communication. About 59% respondents from the investor group identified infrastructural constraint as one of the significant obstacles to FDI inflow in Bangladesh. About 90% policy makers agreed with this view. Therefore, infrastructure is one of the most significant constraints (as majority of both

sample groups identified this) for attracting FDI flow to Bangladesh. Our finding is similar to the findings in the previous literature on FDI in Bangladesh. As both investors and policy makers have identified infrastructure as one of the major barriers in Bangladesh, it is evident that the policy makers are clearly aware of this major problem.

In addition, policy makers also pointed out problems caused by bureaucratic procedures and difficulties in policy implementation as other barriers. Only 11.7% of foreign investors (11.7%) highlighted problems caused by prolonged bureaucratic procedures. Both the groups recognised that bureaucratic procedures prolonged the business starting process and this is one of the important barriers to FDI inflow. Although both groups of respondents identified bureaucratic procedures as a barrier, the fact that only 11.7% of foreign investors considered it as a barrier. About 24% policy makers identified bureaucratic procedures as one of the barriers which is in contrast to the responses by the investors. This suggests that majority of the investors are not much worried about the bureaucratic procedures and have been able to manage with them well. According to previous literature, rigid bureaucratic procedure can restrict the FDI inflow. Although Mian and Alam (2003) argued that bureaucratic procedure is hindering the FDI in Bangladesh, our findings suggest that bureaucratic regime is not seriously hindering the FDI inflow in Bangladesh. This contradicts the findings of previous literature to some extent.

(iii) FDI Policy Regime

About 47% investors felt that present FDI policy regime, that is, government rules, regulations are motivational factors for their investment. However, this percentage does not indicate that majority of investors are satisfied about the present rules, regulations, as six investors did not respond on this issue. It is likely that they do not want to make comments on government policies. Over 72% of investors who responded indicated their satisfaction on the existing policy regime of the government. On the other hand, 80% policy makers felt that the present FDI policy regime is very investment friendly. This suggests the FDI policy regime in Bangladesh is largely perceived as very positive and attractive to investors. But the recent trend of FDI flow to Bangladesh compared to other South Asian countries shows that its record in attracting FDI is not very impressive. This suggests that only having in place an investment supportive policy regime alone is not enough for attracting FDI, capacity of policy implementation is also essential to encourage investment. In this regard some policy makers highlighted that lack of infrastructure, absence of IT facilities and well trained human resources at their department and ministries constrained them from implementing policies efficiently. In contrast, only few investors felt that lack of efficient policy implementation affecting FDI inflow. However, they did not identify specific problems that obstructed facilitating agencies from implementing policies. It implies that investors are not seriously concerned about the limitations of government departments in implementing FDI policies. However, it is evident that government departments have limitations to implement FDI policies, as this is clearly identified by the policy maker group as one of the barriers to facilitate FDI in Bangladesh.

Government policy makers were also asked to evaluate the policies related to FDI. Among 10 policy makers from different ministries and departments 60% opined that policy achievement is satisfactory (although one of them felt that the pace is very slow) and the other 40% said that the

achievement is not very satisfactory. But no one said it was a failure. It is likely that as government officials they may find it difficult to openly say the policy regime is a failure.

(iv) Evaluation of Progress in Attracting FDI Flow to Bangladesh

Among the valid responses of investors 57.14% replied that the progress made in attracting FDI flow is good and satisfactory (4 investors did not respond on this issue). It implies that either the investors are not seriously concerned about the progress made in attracting FDI flow to Bangladesh, or they do not have any idea on this matter. 42.86% said that the progress in FDI flow is not satisfactory. In contrast, the other sample group - policy makers reflected a very positive progress of FDI in the country. That is, 90% policy makers felt that recent FDI inflow was positive and satisfactory. Overall, majority of investors and policy makers rated that in present conditions the FDI inflow is increasing significantly.

(v) Prospective Sectors for Future Investment

When asked to identify the prospective sectors for future FDI, the responses from the foreign investors and policy makers were totally different. While policy makers identified new areas and sectors which has opportunities to attract FDI in future, the investors identified only the areas and sectors in which they are already doing business. This may be because, the investors may not be either interested in other sectors of business or they may not have knew about new and potential areas for FDI in Bangladesh.

(vi) Economic Environment

Previous literature identified factors such as income, GDP growth, interest rate, inflation, large size of the economy, wealth, and natural resources, international agreements that attract investors to the host country. However, in this study two target sample groups: investors and policy makers did not identify these factors as drivers of investment in Bangladesh. It suggests that macro economic indicators or size of the economy did not influence investors to invest in Bangladesh. According to previous literature resource seeking FDI is induced by the size and growth of the economy. From the view point of foreign investors in our sample this finding is consistent with the previous literature as this study purely based on the foreign investors of EPZ area where the FDI is not resource seeking rather it is export oriented. This study only focused on the investors in EPZs and this may be the reason that they are not seriously concerned about the economic conditions in Bangladesh. Apart from this 17.54% investors also mentioned that as Bangladesh got GSP facilities to the EU, they were motivated to invest in Bangladesh. In other words, overall, it seems that both investors and policy makers are not seriously concerned about the economic conditions of the country affecting the FDI flow.

(vii) Political Climate

Previous studies empirically found that political climate can deteriorate the investment environment. It includes corruption, frequent change of the Government, absence of

accountability and transparency of the Government, and terrorism, which could negatively affect FDI inflows to a host country. Previous studies also identified that political unrest is one of the barriers which is slowing down the FDI inflow to Bangladesh (Mondal, 2003, Kafi *et al* 2007; Alam *et al* 2006). In our study what is interesting is that only one foreign investor out of 17 respondents found political unrest/ instability as a barrier for investment in Bangladesh. None of the policy maker from our sample identified it as a barrier to FDI flow. Again this may be because they are government officials and felt constrained from making comments on the political unrest as a barrier to FDI. However, we feel that the fact only one of the 17 foreign investors identified political unrest as a barrier to FDI contradicts the arguments and findings from previous literature. This suggests that the political climate is not seriously hindering the FDI inflow to Bangladesh. On the other hand, it is also likely that as Bangladesh is moving towards being a politically stable and democratic country, the foreign investors are taking a long-term view of the political climate and are not unduly concerned about short-term political unrest in the country. Furthermore, as this study is restricted to the EPZs, the investors may not consider political unrest as a major barrier to the FDI inflow in Bangladesh.

(viii) Institutional Factors and Government Initiatives

Previous literature has shown that Government initiatives, incentives, assistance, monitoring, liberalization, tax reduction, grants, less bureaucratic regime, neutral legal framework, quality of institutions, free from or less corruption, transparency, and banking, tax and tariff reforms can play a pivotal role in attracting FDI. About 47% investors expressed their satisfaction on the existing government initiatives, rules, regulations and incentives and indicated that these factors motivated them to invest in Bangladesh. On the other hand, 80% policy makers expressed satisfaction on this matter. Particularly, investors also said that tax holiday provided by Foreign Private Investment (Promotion and Protection), 1989 also influenced their decision to invest in Bangladesh. Previous literature also found this indicator which increases FDI inflow. It appears that government policy initiatives such as tax holiday are playing an important role in attracting FDI.

As already discussed above, the perceptions of bureaucratic procedures as barriers among the target sample groups are different. About 24% of the policy makers felt that this is a barrier while only one out of 17 foreign investors identifies it as a problem. Policy makers closely related to the bureaucratic process felt that it is possible to make these procedures faster by employing appropriate logistics and resources. It is possible that foreign investors do not feel that bureaucratic procedures are seriously hindering the FDI inflow, because they perceive that Bangladesh is improving its FDI policy implementation and trying to simplify the bureaucratic procedures.

To summarize, majority of both sample groups - foreign investors and policy makers – have identified the availability of low cost labour as the main determinant for attracting FDI flow to Bangladesh and majority of both groups identified lack of good infrastructure as the main constraint to FDI flow. Surprisingly, both groups also expressed satisfaction with the existing FDI policy regime (but about 40% investors did not respond to this issue) and about the progress made by Bangladesh in attracting FDI flow (but 43% of investors expressed dissatisfaction with

the progress made). While the foreign investors identified the same sectors where they are operating as prospective sectors for future investment, the policy makers identified new sectors for future FDI promotion. Surprisingly, political instability and weak macroeconomic environment were not considered as serious barriers to FDI flow by both investors and the policy makers. Again surprisingly, only 60% of the policy makers expressed dissatisfaction with the performance of FDI policy regime in terms of results and outcomes.

6. Conclusions and Recommendations

The main objective of this study was to find out the major determinants and barriers for FDI flow in Bangladesh. For this, we surveyed two groups of stakeholders: foreign investors in Export Processing Zones (EPZs) and policy makers in the government and analysed the data employing an analytical framework derived from previous FDI related literature. Previous literature identified macroeconomic performance, incentives and geographical location advantages as the motivational factors attracting foreign investors to Bangladesh. Previous literature also has shown that large size of the economy, inflation, rate of interest, GDP growth influenced largely investors to make investment in a country. This study empirically found that these factors did not play any role as major motivational factors for foreign investment. This may be because our study was based on the perceptions and experiences of foreign investors specifically working in EPZs. As previous literature highlighted that export oriented FDI does not consider the size and growth of the economy, our findings do not contrast previous findings in this aspect. Similarly, policy makers also do not perceive macroeconomic conditions as important factors which influenced FDI in Bangladesh. Although this perception may reflect their experience with FDI flow to EPZs, they have to be cautious and they should not ignore the importance of these factors in influencing the FDI flow into areas outside EPZs in Bangladesh.

The FDI literature highlighted that government interventions and incentives play as a motivational factor towards attract investors. Although both the sample groups in our study did not mention government policies and incentives as major motivational factors, majority of policy makers and investors perceived present policies as positive and encouraging for foreign investors and particularly foreign investors appear to be satisfied about the functioning of present policy regime. This is also reflected by the increased volume of FDI flow to Bangladesh particularly since policy reforms were introduced in the 1990s.

We found that the most attractive factor for FDI flow to Bangladesh is the low cost of labour in the country and it is also consistent with the previous literature which identified that the main objective of export oriented FDI is to minimize cost. Infrastructural facilities are always important to attract FDI in any country. In terms of impediments to FDI inflow previous literature found that political unrest and infrastructural constraints restricts FDI inflow. This study found that investors did not consider that political conditions are hindering the investment climate in Bangladesh. However, both sample groups in our study (foreign investors and policy makers) identified infrastructure as a major barrier to FDI. These include lack of quality power supply, transport communication, and gas. Despite recognising some barriers, most of the investors appear to be satisfied about the present investment climate in Bangladesh and expressed their interest in making further investment in the country.

Majority of investors and policy makers evaluated that the existing rules and regulations governing FDI flow are satisfactory. However, they also suggested some measures to make these more investment friendly. For example, investors mostly emphasized on the simplification of custom procedures and making unambiguous laws and policy makers pointed out the need for putting in place technological and human resources for efficient implementation of FDI policy regime. Policy makers also identified some infrastructural constraints at their departments which restrict them to implement more effectively the FDI policies.

While the investors identified their own existing sectors of operations as potential areas for future investment and expressed interest to invest in them, the policy makers identified totally new sectors as potential areas for future FDI flow. It is quite obvious that investors are more keen on investing in their existing business sectors, this also may be because they may not be aware of opportunities to make future investment in new sectors in Bangladesh due to lack of promotion on the part of policy makers.

On the basis of the above findings from both the stakeholders the following policy recommendations are made:

- (a) Government should take necessary steps immediately to improve the utility facilities (Power and Gas). To do this Government can encourage and provide special incentive packages for certain period of time to local and foreign investors who will invest in this sector. This recommendation will improve the total utility infrastructure in the country and industrial development process as well.
- (b) Government should provide necessary infrastructural facilities to the Government agencies facilitating FDI flow (such as IT and well trained human resources) to achieve efficient implementation of FDI policies. Monitoring and Evaluation (M & E) system can also be introduced in these agencies to observe the efficient functioning of these agencies. Feedback from investors on quarterly basis can also be initiated to improve the service delivery system of these agencies/departments and ministries. This measure also will help make their function more transparent.
- (c) Bureaucratic procedure related to FDI should be more simplified. Bangladesh Board of Investment presently is providing one stop services to the investors who are making investment outside the EPZ area. Although this study mainly focused on investors of EPZs, the investors identified that decision making is prolonged due to the complex bureaucratic procedures. In this perspective BEPZA also can introduce such one stop service facilities. This will help to reduce the time to set up an industry in EPZ area.
- (d) Policy makers have identified new prospective areas for investment which are not recognized by the investors. These areas should be promoted and prioritized based on long-term economic development strategy.

Finally, it appears that Bangladesh has put in place a relatively investment-friendly policy regime which has helped to attract significant FD flow particularly since 1990s. If the government can implement these policies more efficiently with an effective management system then it is likely

that both volume and outcome of the FDI will increase and contribute more to the national economy in Bangladesh.

Notes

¹ The figures for FDI inflow in Non-EPZ area was computed by subtracting FDI inflow in EPZ area from the total FDI inflow to Bangladesh.

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